



# The Knowledge



## Serviced Apartment Overview



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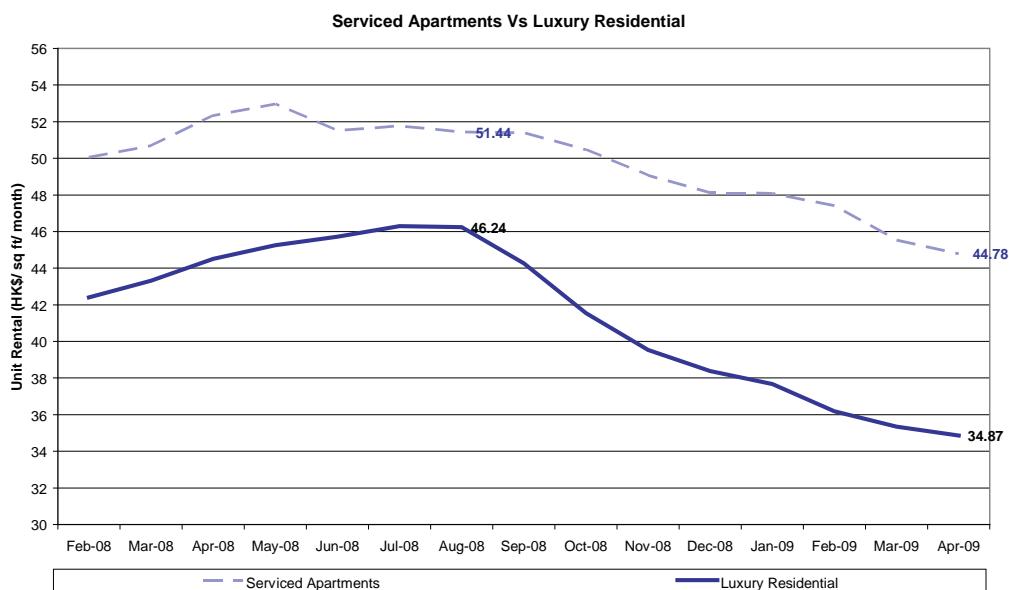
### INTRODUCTION

Due to the onset of the global financial turmoil and its knock-on effect on the global economy, the local luxury residential market has shown distinct signs of consolidation since 3Q2008. In addition to the contraction of the financial industry after the collapse of Lehman Brothers in September 2008, other business sectors, ranging from legal and technology to trading, also received a blow as a result of the retreat in global demand.

In order to weather the economic storm, cost-cutting initiatives have been put on the top of the agenda at most multinational corporations. The key measures implemented so far have included staff retrenchments and the reduction of housing budgets, which have gradually led to a decline in market volume and a change in the demand structure in the residential leasing sector.

Despite the fact that there was no completion of a major new development during the period between 3Q2008 and April 2009, the availability of stock for lease in the secondary market remained plentiful throughout the period. Because of the problem of the credit crunch and the cautious lending policy adopted by banks towards real estate financing, the leasing market was basically in a cut-throat situation during the three-month period between October and November 2008 when the liquidity of the sales market virtually dried up. Desperate individual landlords resorted to offering their units for lease rather than sale, causing residential rentals to take a quick, steep plunge during 4Q2008.

Average rental rates in the serviced apartment market declined 6.4% QoQ and 5.4% QoQ in 4Q2008 and 1Q2009, respectively. The pace of rental fall slowed to -1.7% MoM, at HK\$44.78 per sq ft per month as of April 2009



Source: Colliers International (Hong Kong) Limited

### RENTAL DIRECTION

According to our research, average luxury residential rentals fell 13% quarter-on-quarter (QoQ) in 4Q2008, although the pace of downward adjustment narrowed to 8% QoQ in 1Q2009 as inexpensive opportunities were snapped up by early-bird occupiers. In April 2009, the rate of decline in rentals tapered off further to less than 2% month-on-month (MoM), with the average unit rate settling at HK\$34.87 per sq ft per month.

In the serviced apartment market, the overall performance has been relatively more resilient than in the luxury residential market. Average rental rates in the serviced apartment market declined 6.4% QoQ and 5.4% QoQ in 4Q2008 and 1Q2009, respectively. The pace of rental fall slowed to -1.7% MoM, at HK\$44.78 per sq ft per month as of April 2009.

With reference to the rental trend of the local serviced apartment and luxury residential sector, the rental difference suggests that the former has been less vulnerable to the current market downturn. During the peak of the market in 2008, the rental difference between the two sectors was HK\$5.20. As of April 2009, the difference had expanded to nearly HK\$10.00, suggesting that rentals in the

serviced apartment sector have been holding up relatively well.

### THE KEY CHANGES

Notwithstanding the fact that rentals in the serviced apartment market have been resilient, the sector has been challenged by the global economic downturn since the onset of the financial crisis in 4Q2008. As far as the demand fundamental is concerned, the following is a summary of the key changes during the first four months of 2009.

Due to the general cut-back in expenses and outgoings in the private sector, the serviced apartment market saw a significant contraction in leasing demand since the beginning of 2009. Firstly, there was a substantial reduction in the number of summer interns, who have been one of the key demand groups for short-term serviced units, such as studio-type apartments. Secondly, the structure of leasing demand changed as the leasing market was characterised by an increase in local relocations during March and April 2009 following a significant reduction in rentals. A number of occupiers have chosen to either relocate to cheaper areas or to downgrade to other alternatives in terms of size and quality, given the general tightening of housing budgets.

SERVICED APARTMENTS (BY LENGTH OF LEASE TERM)

| TERM                 | 1998       | 1999       | 2000       | 2001       | 2002       | 2003       | 2004       | 2005       | 2006       | 2007       | 2008       | 2009<br>(JAN - APR) | AVERAGE    |
|----------------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|---------------------|------------|
| <b>SHORT LEASES</b>  | <b>56%</b> | <b>71%</b> | <b>54%</b> | <b>58%</b> | <b>66%</b> | <b>64%</b> | <b>69%</b> | <b>56%</b> | <b>74%</b> | <b>84%</b> | <b>81%</b> | <b>75%</b>          | <b>67%</b> |
| SHORTER THAN 2 WEEKS | 0%         | 0%         | 2%         | 0%         | 2%         | 2%         | 0%         | 0%         | 0%         | 0%         | 1%         | 0%                  | 1%         |
| 2 WEEKS TO 1 MONTH   | 8%         | 8%         | 0%         | 2%         | 2%         | 2%         | 0%         | 0%         | 1%         | 0%         | 0%         | 0%                  | 2%         |
| 1 - 3 MONTHS         | 44%        | 54%        | 31%        | 48%        | 53%        | 38%        | 62%        | 46%        | 60%        | 73%        | 66%        | 64%                 | 52%        |
| 3 - 6 MONTHS         | 4%         | 8%         | 21%        | 8%         | 10%        | 21%        | 7%         | 10%        | 13%        | 12%        | 15%        | 11%                 | 12%        |
| <b>LONG LEASES</b>   | <b>44%</b> | <b>29%</b> | <b>46%</b> | <b>42%</b> | <b>34%</b> | <b>36%</b> | <b>31%</b> | <b>44%</b> | <b>26%</b> | <b>16%</b> | <b>19%</b> | <b>25%</b>          | <b>33%</b> |
| 6 - 12 MONTHS        | 16%        | 4%         | 15%        | 15%        | 19%        | 4%         | 7%         | 7%         | 11%        | 8%         | 6%         | 18%                 | 10%        |

Source: Colliers International (Hong Kong) Limited

Despite the recent changes in the external environment, the demand structure in terms of the average length of a lease term in the serviced apartment market remained largely unchanged during the first four months of 2009

In view of the general contraction in demand, vendors have been offering competitive rentals in order to fill their units. In the lower end of the market, demand for studio-type units has been relatively steady as rentals have been cut to a level matching the housing budgets for most occupiers. Meanwhile, individual serviced apartment operators whose portfolios comprise medium-to-large units made a significant change in their leasing strategies towards the end of 1Q2009. On a comparative basis, rentals for medium-to-upper-end units saw a steeper cut than those in the serviced apartment market as a whole. For example, the asking rental for a two-bedroom suite fell 26% from HK\$70,000 per month in 1Q2009 to HK\$52,000 per month as of May 2009. Meanwhile, a sizeable three-bedroom unit experienced a 22% cut in rental from HK\$180,000 per month to the current level of HK\$140,000 per month.

**LENGTH OF LEASE TERM**

Despite the recent changes in the external environment, the demand structure in terms of the average length of a lease term in the serviced apartment market remained largely unchanged during the first four months of



2009. According to our research, the number of short leases (i.e. with terms of six months or less) concluded during the period constituted 75% of the pie. This was actually a reduction compared with the average percentage of 84% registered in 2007 and the first half of 2008, and was attributed to the lack of residential units available for lease during the previous market upswing. Occupiers have thus resorted to short-term accommodation in the serviced apartment sector before securing long-term leases in the luxury residential market. Overall, there was a contraction in the number of short-term relocations after the onset of the financial turmoil, although the percentage of short leases remained above its long-term average at 67%.



**SUPPLY CONDITIONS**

On the supply front, although there was no completion of any major brand new serviced apartment developments during the first four months of 2009, the number of serviced units available for lease, in terms of the overall occupancy rate, increased as a result of the contraction in the demand side of the market.

## TRANSACTION BREAKDOWN (BY REGION)

| TERM                             | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009<br>(JAN - APR) | AVERAGE |
|----------------------------------|------|------|------|------|------|------|------|------|------|------|------|---------------------|---------|
| HONG KONG CENTRAL                | 88%  | 58%  | 31%  | 83%  | 39%  | 51%  | 31%  | 55%  | 61%  | 53%  | 57%  | 61%                 | 55%     |
| HONG KONG EAST                   | 4%   | 4%   | 19%  | 4%   | 3%   | 2%   | 10%  | 13%  | 15%  | 16%  | 12%  | 21%                 | 9%      |
| HONG KONG WEST                   | 0%   | 0%   | 33%  | 12%  | 12%  | 17%  | 17%  | 10%  | 0%   | 4%   | 6%   | 0%                  | 10%     |
| HONG KONG SOUTH                  | 8%   | 29%  | 8%   | 2%   | 29%  | 26%  | 21%  | 11%  | 14%  | 16%  | 10%  | 4%                  | 16%     |
| TSIM SHA TSUI                    | 0%   | 8%   | 6%   | 0%   | 14%  | 4%   | 17%  | 9%   | 8%   | 10%  | 15%  | 14%                 | 8%      |
| TSIM SHA TSUI EAST<br>& HUNG HOM | 0%   | 0%   | 2%   | 0%   | 3%   | 0%   | 2%   | 2%   | 0%   | 0%   | 0%   | 0%                  | 1%      |
| WEST KOWLOON                     | 0%   | 0%   | 0%   | 0%   | 0%   | 0%   | 0%   | 0%   | 0%   | 0%   | 1%   | 0%                  | 0%      |
| NEW TERRITORIES                  | 0%   | 0%   | 0%   | 0%   | 0%   | 0%   | 2%   | 0%   | 1%   | 0%   | 0%   | 0%                  | 0%      |

Source: Colliers International (Hong Kong) Limited

*According to our research, rentals in the luxury residential market are expected to fall 12% over the next 12 months, although the potential rental downside in the serviced apartment sector will be limited to 8% over the same period*

**GardenEast** is the one of major brand new serviced apartment developments completed in the past six months. The development, located at 222 Queen's Road East, Wanchai, was completed in 4Q2008 and offers a total of 216 serviced apartment units with sizes ranging from 395 sq ft to 672 sq ft at HK\$16,700 to HK\$26,100 per month. Besides GardenEast, there were a couple of small-to-medium size schemes with 80 units or less per development came onto the market during the past six months.

#### MARKET OUTLOOK

Without a near-term recovery in the external environment or concrete signs justifying business growth, the overall residential leasing market will continue to face the challenge of sustained weakness in occupational demand and the cost-cutting initiatives among multinational companies.

However, given the unique services and flexible lease terms available in the serviced apartment sector, it is our view that this sector will continue to be resilient. Although the serviced apartment market is predicted to consolidate over the near to medium term, the challenge in the luxury residential leasing market might represent opportunity for the sector. For example, a number of occupiers may prefer to stay in serviced apartment units on short-term leases with a term of three months or less as they would consider moving into standard luxury residential units on a longer lease (1-2 years) only when the market shows signs of stabilisation. According to our research, rentals in the luxury residential market are expected to fall 12% over the next 12 months, although the potential rental downside in the serviced apartment sector will be limited to 8% over the same period.